REPORT OF EXAMINATION
OF THE

SEQUOIA INSURANCE COMPANY

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed February 20, 2008

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San Francisco,

California

December 19, 2007

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Kent Michie
Secretary, Zone IV-Western
Commissioner of Insurance
Department of Insurance, State of Utah
Salt Lake City, Utah

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

SEQUOIA INSURANCE COMPANY

(hereinafter referred to as the Company) at its home office located at 70 Garden Court, Monterey, California 93940.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination. The examination was made pursuant to the National Association of Insurance

Commissioners' plan of examination. This examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

In May of 2000, the Company purchased all of the issued and outstanding shares of Personal Express Insurance Services, Inc. a California licensed personal lines insurance agency. This acquisition was approved by the California Department of Insurance (CDI) on April 25, 2000.

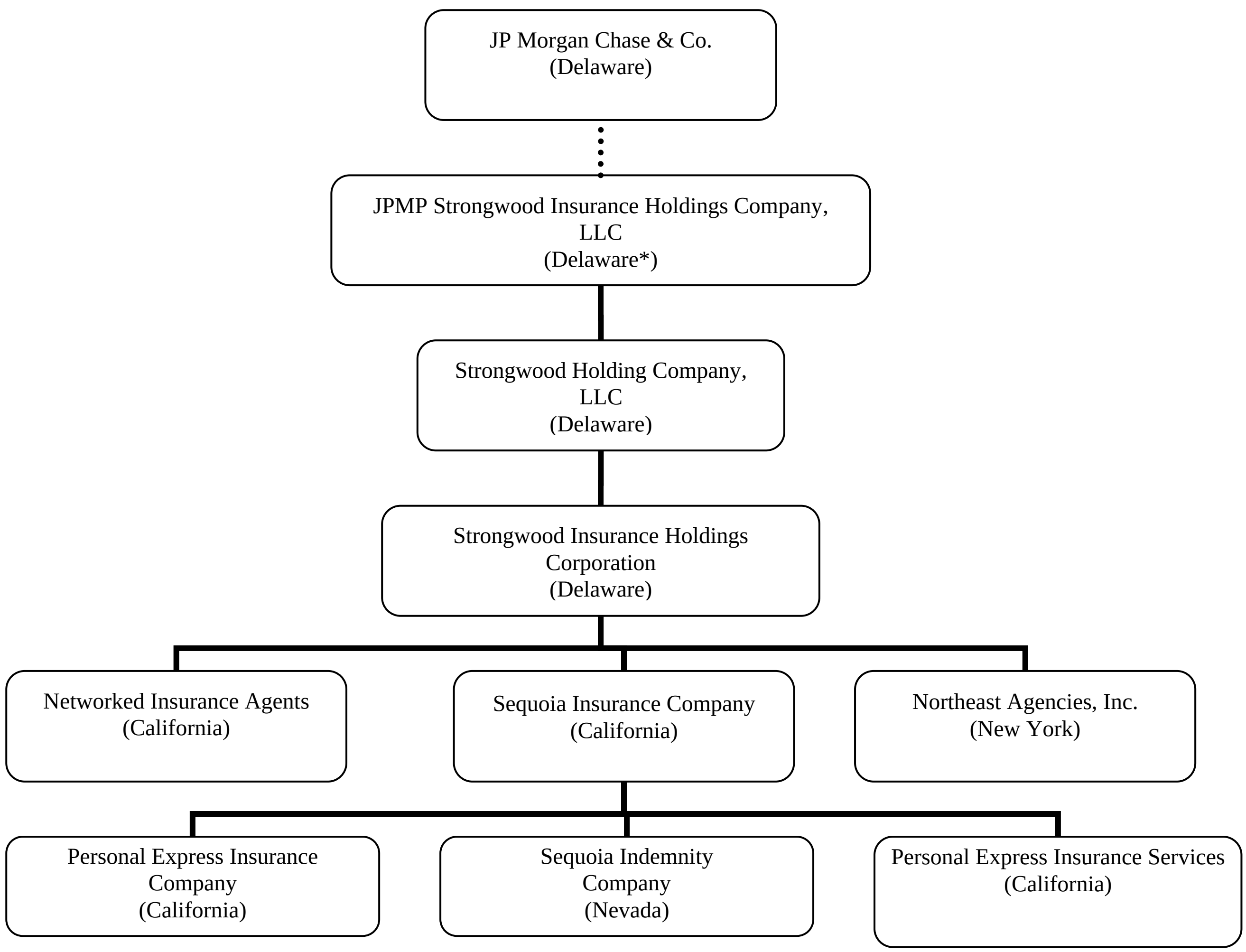
On March 31, 2003, Strongwood Insurance Holdings Corporation (Strongwood) acquired all the issued and outstanding shares of capital stock of the Company in accordance with a Stock Purchase Agreement dated October 21, 2002 between Strongwood, Physicians Insurance Company of Ohio (Physicians) and PICO Holdings, Inc. (PICO). The ultimate controlling party of Strongwood is J.P. Morgan Chase & Company, a Delaware corporation. The CDI elected to abstain from objection to the acquisition on March 17, 2003, pursuant to California Insurance Code (CIC) Section 1215.2.

In conjunction with the sale, the Company paid an extraordinary dividend in the amount of $17,857,271. This transaction was also reviewed by the CDI and the CDI abstained from objection.

The Company received a capital contribution from its parent in the amount of $1,476,803 during 2006 which was the statutory value of the common stock of Sequoia Indemnity Company (Indemnity) as of the contribution date. The Company then made a capital contribution of $5,290,251 in securities and accrued interest to Indemnity. The Company also made a capital contribution to its other wholly-owned subsidiary, Personal Express Insurance Company, in the amount of $10,040,738 during 2006. These contributions were made pursuant to CIC Section 1215.1 and required no prior approval.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system in which J.P. Morgan Chase & Co, (JPMC) a Delaware corporation, is the ultimate controlling entity. The Company is a wholly-owned subsidiary of Strongwood Insurance Holdings Corporation. The following chart depicts the interrelationship of the companies within the holding company system as of December 31, 2006:



*Ownership is 95.8%. All others are 100%

Management of the Company is vested in a five-member board of directors. As of December 31, 2006, the directors and principal officers were as follows:

Directors

Name and Residence	Principal Business Affiliation
Jason S. Friedman* Short Hills, New Jersey	Principal, CCMP Capital Advisors, LLC
Michael Hegarty Briarcliff Manor, New York	Retired
Stephen P. Murray Stamford, Connecticut	President, CCMP Capital Advisors, LLC
Richard J. Quagliaroli West Hartford, Connecticut	Chairman, CEO, President and Secretary, Strongwood Insurance Holdings Corporation
William M. Stuek* Darien, Connecticut	Managing Director, CCMP Capital Advisors, LLC

* Resigned in early 2007, not replaced. The bylaws require five directors.

Principal Officers

Name	Title
Richard J. Quagliaroli	President, Chief Executive Officer and Secretary
Jeffrey H. Marshall	Vice President, Chief Financial Officer and Treasurer
Carola A. Hogan	Vice President, Claims
Joel L. Bethke	Vice President, Underwriting
Thomas G. Moylan	Vice President, Chief Actuary
David E. Brandeis	Vice President, Information Systems
Charles M. O'Halloran	Vice President

Intercompany Agreements

The Company, its parent and affiliates file a consolidated federal income tax return under the provisions of a tax allocation agreement, which was effective March 31, 2003. Each subsidiary is required to compute its tax liability as if it filed a separate federal return. Payment of the consolidated tax liability is the responsibility of the parent. The California Department of Insurance (CDI) abstained from objection to this agreement on March 17, 2003.

The Company entered into an agency agreement with an affiliate, Networked Insurance Agents (Networked), effective March 31, 2003 to produce business for the Company. The CDI abstained from objection to this agreement on March 17, 2003. Networked wrote about $7.5 million in commercial premiums for the Company in 2006.

The Company and its parent, Strongwood Insurance Holdings Corporation, (Strongwood), entered into a Services and Investment Management Agreement effective March 31, 2003. Under the terms of the agreement, Strongwood provides investment management, administrative and facilities services to the Company. The administrative services include financial reporting, tax compliance, treasury, actuarial, policy and claims administration and other various services. The Company pays Strongwood for these services and facilities based on time allocations, expense sharing and actual cost. The CDI abstained from objection to this agreement on March 17, 2003.

The Company and its wholly-owned subsidiary, Sequoia Indemnity Company (Indemnity) entered into a Services Agreement effective November 1, 2005. Under the terms of the agreement, the Company provides Indemnity with services similar to those provided by Strongwood to the Company listed in the preceding paragraph. The CDI abstained from objection to this agreement on October 11, 2005.

CORPORATE RECORDS

The Company amended its bylaws through December 19, 2003, but did not file the amendment with the California Department of Insurance (CDI) pursuant to the Annual Information Statement. The Company submitted the amended bylaws on October 3, 2007.

The Company also amended its Articles of Incorporation on August 3, 2004 to increase the par value per share of its common stock from $6.50 to $7.50 per share. Notice was filed with the CDI on August 14, 2004, pursuant to California Insurance Code Section 827.3(b) (3).

TERRITORY AND PLAN OF OPERATION

The Company is a California domiciled insurance company which transacts property and casualty insurance business. The primary lines of business are commercial multiple peril, workers' compensation, farmowners multiple peril, auto physical damage, homeowners multiple peril, and private passenger auto liability, which account for 56%, 12%, 7%, 7% , and 5% respectively, of the $110,299,215 total direct premiums written in 2006.

As of December 31, 2006, the Company is licensed in the following states: Alabama, Arizona, Arkansas, California, Colorado, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming. The Company is also licensed in the District of Columbia.

The Company wrote 86% of its direct premiums for 2006 in California, with another 11% in Nevada. Arizona, Colorado, Oregon, Utah, and Washington make up the remainder of direct premiums written in 2006.

The Company writes coverage primarily for small to medium size commercial establishments and farms in northern and central California. A modest amount of earthquake coverage is also written as an endorsement. Commercial auto is written in conjunction with other commercial lines.

During 1999, the Company began writing homeowners business and expanded into the personal auto business. Business is produced through the Company's wholly-owned personal lines agency, Personal Express Insurance Services, Inc. (Personal Express), an affiliated agency, Networked Insurance Agents (Networked), and about 165 independent agents and brokers. Commission rates range between 10% and 20% for the independent agents and brokers and 18% for Networked. No commissions are paid on business written by Personal Express.

REINSURANCE

Assumed

The Company assumes minimal reinsurance from two pools; the California Commercial Auto Insurance Procedure, and the National Council on Compensation Insurance Inc.

Ceded

The following is a summary of the principal reinsurance agreements in effect as of December 31, 2006.

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Limits
First Excess Mutiple Line (Property and Casualty)	Authorized: Endurance Reinsurance Corporation of America 35% GE Reinsurance Corporation 15% Hannover Ruckeversicherungs-Aktiengesellschaft 15% Aspen Insurance UK Limited 10% Employers Reinsurance Corporation 5% Sequoia Insurance Company 20%*	$500,000 plus 20%*	$1.5 million in excess of $500,000 subject to a maximum of $4.5 million per occurrence.

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Limits
Second Excess Property	<u>Authorized:</u> Endurance Reinsurance Corporation of America 20% GE Reinsurance Corporation 25% Hannover Ruckeversicherungs-Aktiengesellschaft 20% Aspen Insurance UK Limited 19% Employers Reinsurance Corporation 15% <u>Unauthorized:</u> Catlin Insurance Company Ltd 1%	$2 million	$3 million in excess of $2 million subject to a maximum of $9 million per occurrence.
Third Excess Property	<u>Authorized:</u> GE Reinsurance Corporation 25% Lloyd's Syndicate #2001- AMLIN Underwriting Ltd 20% Lloyd's Syndicate #2010 – Cathedral Underwriting Limited 17.5% Lloyd's Syndicate # 2003 – Catlin Underwriting Agencies 10% Hannover Ruckeversicherungs Aktiengesellschaft 15% Employers Reinsurance Corporation 10.5%	$5 million	$5.5 million in excess of $5 million subject to a maximum of $11 million per occurrence.
Second Excess Casualty	<u>Authorized:</u> GE Reinsurance Corporation -30% Liberty Mutual Insurance Company – 15% Hannover Ruckeversicherungs Aktiengesellschaft 10% Employers Reinsurance Corporation 5% <u>Unauthorized:</u> Endurance Specialty Insurance, Ltd 40%	$2 million	$3 million in excess of $2 million subject to a maximum of $2 million per occurrence.
Third Excess Casualty	<u>Authorized:</u> Arch Reinsurance Company 17.5% Federal Insurance Company 17.5% GE Reinsurance Company 15% Liberty Mutual Insurance Company 15%	$5 million	$10 million in excess of $5 million subject to a maximum of $2 million per occurrence.

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Limits
	<u>Unauthorized:</u> Endurance Specialty Insurance, Ltd 30% Catlin Insurance Company 5%		
First Umbrella Quota Share	<u>Authorized:</u> Employers Reinsurance (5/28/06 to 12/31/06)	5% of the first $2 million on personal and 5% of first $5 million for other lines.	95% of the first $2 million on personal and 95% of first $5 million on other lines, subject to a loss limit of $5 million.
Second Excess Umbrella	<u>Authorized:</u> Employers Reinsurance	$0	$5 million in excess of $5 million subject to a loss limit of $10 million.
First Excess Property Catastrophe	<u>Authorized:</u> Lloyd's Syndicate #2001 AMLIN Underwriting, Ltd. 15% Lloyd's Syndicate #2010 Cathedral Underwriting Limited 5% Mapfre Re Compania de Reaseguros, S.A. 4% <u>Unauthorized:</u> Axis Specialty Limited 50% Validus Reinsurance Limited 11% Max Re, Ltd. 10%	$2.5 million	$5 million in excess of $2.5 million subject to a maximum of $5 million per occurrence.
Second Excess Property Catastrophe	<u>Authorized:</u> Lloyd's Syndicate #2001 AMLIN Underwriting, Ltd. 15% Mapfre Re Compania de Reaseguros, S.A. 4% Hannover Ruckeversicherungs Aktiengesellschaft 4% Lloyd's Syndicate #2010 Cathedral Underwriting Limited 4% Lloyd's Syndicate #2020 Wellington Underwriting 4% <u>Unauthorized:</u> Axis Specialty Limited 50%	$7.5 million	$10 million in excess of $7.5 million subject to a maximum per occurrence of $10 million.

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Limits
	Validus Reinsurance Limited 10% Max Re, Ltd. 9%		
Third Excess Property Catastrophe	<u>Authorized:</u> Lloyd's Syndicate # 2001 – AMLIN Underwriting Ltd. 15% Mapfre Re Compania de Reaseguros, S.A. 8% Lloyd's Syndicate #2001 AMLIN Underwriting, Ltd. 15% Hannover Ruckeversicherungs Aktiengesellschaft 6% Lloyd's Syndicate #2020 Wellington Underwriting 4% <u>Unauthorized:</u> Axis Specialty Limited 50% Validus Reinsurance Limited 8% Max Re, Ltd. 5%	$17.5 million	$18.5 million in excess of $17.5 million subject to a maximum of $18.5 million per occurrence.
First Excess – Workers' Compensation and Employment Practices Liability	<u>Authorized:</u> Hannover Ruckeversicherungs Aktiengesellschaft 35% Aspen Insurance UK, Ltd.35% GE Reinsurance 30%	$250,000	$750,000 in excess of $250,000.
Second Excess – Workers' Compensation and Employment Practices Liability (EPL)	<u>Authorized:</u> Hannover Ruckeversicherungs Aktiengesellschaft 45% Aspen Insurance UK, Ltd. 32.5% Lloyd's Syndicate #2020 Wellington Underwriting 22.5%	$1 million	$4 million in excess of $1 million. Maximum $2 million for EPL.
Third Excess Per Occurrence– Workers' Compensation and Employment Practices Liability (EPL)	<u>Authorized:</u> Hannover Ruckeversicherungs Aktiengesellschaft 30% Aspen Insurance UK Ltd. 25% Lloyd's Syndicate #2020 Wellington Underwriting 22.5% Lloyd's Syndicate #2987 Brit Syndicates Limited 22.5%	$5 million	$5 million in excess of $5 million subject to a maximum of $10 million per term. Maximum $2 million for EPL.
Third Excess Per Person – Workers' Compensation	<u>Authorized:</u> Hannover Ruckeversicherungs	$5 million	$5 million in excess of $5 million each

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Limits
and Employment Practices Liability (EPL)	Aktiengesellschaft 30% Aspen Insurance UK, Ltd. 25% Lloyd's Syndicate #2020 Wellington Underwriting 22.5% Lloyd's Syndicate #2987 Brit Syndicates Limited 22.5%		person per occurrence. Maximum of $2 million for EPL.
Fourth Excess – Workers' Compensation and Employment Practices Liability (EPL)	<u>Authorized:</u> Hannover Ruckeversicherungs Aktiengesellschaft 30% Aspen Insurance UK, Ltd. 25% Lloyd's Syndicate #2020 Wellington Underwriting 22.5% Lloyd's Syndicate #2987 Brit Syndicates Limited 22.5%	$10 million	$10 million in excess of $10 million per occurrence. Maximum of $20 million per term and $5 million any one life. Maximum $2 million for EPL.

The Company has a 100% Quota Share treaty with Hartford Steam Boiler Inspection and Insurance Company which covers boiler and machinery breakdown.

As part of the stock purchase agreement between Sydney Reinsurance Corporation (SRC) and Physicians Insurance Company of Ohio (PICO), the Company and SRC entered into a reinsurance agreement effective July 31, 1995, whereby all policy and claim liabilities of the Company prior to the date of purchase by PICO will be the responsibility of SRC. Payment of these reinsurance liabilities has been unconditionally and irrevocably guaranteed by QBE Insurance Group Limited, an Australian corporation, which owns SRC indirectly. The Company is reimbursed for unallocated loss adjustment expenses according to a management agreement with SRC.

ACCOUNTS AND RECORDS

Claims Practices

A Claims Specialist from the California Department of Insurance reviewed the Company's claims practices and noted that the Company does not have a formal claims manual. It is recommended the Company create a formal claims manual.

The Company utilizes a depreciation schedule for its property and contents losses which is not in compliance with California Code of Regulation (CCR), Title 10, Chapter 5, subchapter 7.5, article 1, section 2695.9 (f) because it does not take into consideration both the age and condition of the item being depreciated. The depreciation schedule currently used by the Company is based solely on the age of the item. It is recommended the Company comply with CCR Title 10, section 2695.9 (f).

The Claims Specialist noted during file reviews that there were violations of California Insurance Code (CIC) Section 790 and the CCR, Title 10, Sections 2695 et al. It is recommended the Company implement procedures to ensure compliance with CIC Section 790 and CCR, Title 10, Sections 2695 et al.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders from December 31, 2002 through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$121,776,696	$	$121,776,696	
Common stocks	16,455,820		16,455,820	
Cash and short-term investments	5,187,851		5,187,851	
Premiums and agents' balances in course of collection	1,916,942	69,531	1,847,411	
Premiums, agents' balances and installments booked but deferred and not yet due	21,896,220		21,896,220	(1)
Reinsurance recoverable on loss and loss adjustment expense payments	386,350		386,350	
Net deferred tax asset	5,236,924	468,753	4,768,171	
Electronic data processing equipment	3,829,417	3,012,542	816,875	
Interest, dividends and real estate income due and accrued	1,322,375		1,322,375	
Receivable from parent, subsidiaries and affiliates	1,010,365		1,010,365	
Other assets nonadmitted	409,255	409,255	0	
Aggregate write-ins for other than invested assets	2,921,679	634,077	2,287,602	
Total assets	$182,349,894	$ 4,594,158	$177,755,736	

Liabilities, Surplus and Other Funds

Losses		$ 33,005,872	(2)
Loss adjustment expenses		17,475,480	(2)
Commissions payable, contingent commissions and other similar charges		5,274,004	
Other expenses		3,764,123	
Taxes, licenses and fees		78,285	(3)
Federal and foreign income taxes		1,996,101	
Unearned premiums		51,690,521	
Advance premiums		521,875	
Ceded reinsurance premiums payable		3,786,371	
Funds held by company under reinsurance treaties		147,225	
Amount withheld or retained by company for account of others		93,348	
Payable to parent, subsidiaries, and affiliates		272,560	
Aggregate write-ins for liabilities		(6,260,866)	
Total liabilities		111,844,899	
Aggregate write-ins for other than special surplus funds	$ 6,233,426		
Common capital stock	3,000,000		
Gross paid-in and contributed surplus	54,811,526		
Unassigned funds (surplus)	1,865,885		
Surplus as regards policyholders		65,910,837	
Total liabilities, surplus and other funds		$177,755,736	

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Statement of Income

Underwriting Income		
Premiums earned		$88,021,659
Deductions:		
Losses incurred	$31,509,575	
Loss expenses incurred	12,725,384	
Other underwriting expenses incurred	34,903,320	
Total underwriting deductions		79,138,279
Net underwriting gain		8,883,380
Investment Income		
Net investment income earned	$ 5,239,972	
Net realized capital losses	(391,619)	
Net investment gain		4,848,353
Other Income		
Net loss from agents' or premium balances charged off	$ (95,555)	
Finance and service charges not included in premiums	423,644	
Aggregate write-ins for miscellaneous income	1,134	
Total other income		329,223
Net income before federal and foreign income taxes		14,060,956
Federal and foreign income taxes incurred		5,701,202
Net income		$ 8,359,754

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		$57,397,375
Net income	$8,359,754	
Net unrealized capital gains	(351,972)	
Change in net deferred income tax	2,192,824	
Change in nonadmitted assets	(3,163,947)	
Surplus: Paid-in	1,476,803	
Change in surplus as regards policyholders		8,513,462
Surplus as regards policyholders, December 31, 2006		$65,910,837

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2006

Surplus as regards policyholders, December 31, 2002, per Examination			$32,301,520
	Gain in Surplus	Loss in Surplus	
Net income	$14,076,284		
Net unrealized capital losses		1,334,499	
Change in net deferred tax	4,002,543		
Change in nonadmitted assets		4,050,544	
Capital: Paid-in	18,257,271		
Surplus: Paid-in	14,476,803		
Transferred to capital		400,000	
Dividends to stockholders		17,857,271	
Special surplus from retroactive reinsurance	6,438,730		
Total gains and losses	$57,251,631	$23,642,314	
Increase in surplus as regards policyholders			33,609,317
Surplus as regards policyholders, December 31, 2006, per Examination			$65,910,837

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Deferred Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due

Included in this account is an estimate for Earned but Unbilled Premiums in the amount of $375,000. The Company is not in compliance with Statements of Statutory Accounting Principles (SSAP) 53, paragraph 12, because it did not nonadmit 10% of this amount in excess of collateral specifically held and identifiable on a per policy basis. No adjustment was made as the amount of $37,500 is immaterial. It is recommended the Company comply with SSAP 53, paragraph 12.

(2) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the loss and loss adjustment expense reserves as of December 31, 2006 and concluded that the reserves were reasonable.

(3) Taxes, Licenses and Fees

California Insurance Code (CIC) Section 1872.8(a) states, in part, that each insurer doing business in the State of California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it issues in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in the State of California.

During the course of this examination, it was noted that the Company incorrectly counted the number of its commercial vehicles for 2003 through the first quarter of 2006 because it used vehicles in force on the last day of the quarter. This methodology of counting vehicles is not consistent with the California Department of Insurance Memorandum dated April 2003. It is recommended that the Company submit amended vehicle assessment filings for the affected quarters. No adjustment has been made as the amount due is immaterial.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – (Page 12): It is recommended that the Company create a formal claims manual. It is recommended the Company comply with California Code of Regulations (CCR), Title 10, Section 2695.9(f). It is recommended the Company implement procedures to ensure compliance with California Insurance Code Section 790 and CCR, Title 10, Sections 2695 et al.

Deferred Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due (Page 16): It is recommended the Company comply with Statements of Statutory Accounting Principles 53, paragraph 12.

Taxes, Licenses and Fees (Page 16): It is recommended the Company submit amended vehicle assessment filings for its commercial vehicles for 2003 through the first quarter 2006.

Previous Report of Examination

Reinsurance – Ceded (Page 6): It was recommended that the Company amend its reinsurance agreements to exclude the reference to insolvency in the offset clause. The Company is now in compliance.

Accounts and Records (Page 9): It was recommended the Company evaluate the recommendations from the information systems control review and make appropriate changes to strengthen its information systems controls. The Company has complied.

Losses and Loss Adjustment Expenses (Page 14): It was recommended the Company comply with California Insurance Code (CIC) Section 790.034(b) (1). The Company is now in compliance.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/s/
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Susan Bernard, CFE
Examiner-In-Charge
Senior Insurance Examiner- Supervisor
Department of Insurance
State of California